

ANALYSIS OF ORIGINAL BILL

Franchise Tax Board

Author: Hollingsworth Analyst: Marion Mann DeJong Bill Number: AB 2664
Related Bills: See Legislative History Telephone: 845-6979 Introduced Date: 02/22/2002
Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: Teacher Retention Credit/Increase Credit Amount/Private School and Home-School Credit

SUMMARY

This bill would:

1. expand the teacher retention credit by:
increasing the amount of the credit, and
reducing the years of service requirement to provide credit to teachers with at least one year of service;
2. create a credit for taxpayers whose children attend private school; and
3. create a credit for 50% of the cost of home schooling a child.

PURPOSE OF THE BILL

According to the author's office, the purpose of the changes to the teacher retention credit is to increase the desirability of the teaching profession and to help new teachers that are spending their own money on classroom supplies.

The purpose of the new credits for private school and home schooling is to help offset the cost of alternative education in California.

EFFECTIVE/OPERATIVE DATE

This bill is a tax levy. Thus, it would be effective immediately, and apply to taxable years beginning on or after January 1, 2002.

POSITION

Pending.

Summary of Suggested Amendments

Amendments are needed to resolve the implementation and technical concerns discussed in this analysis. See "Implementation Considerations" and "Technical Considerations" below.

Board Position:

<input type="checkbox"/> S	<input type="checkbox"/> NA	<input type="checkbox"/> NP
<input type="checkbox"/> SA	<input type="checkbox"/> O	<input type="checkbox"/> NAR
<input type="checkbox"/> N	<input type="checkbox"/> OUA	<input checked="" type="checkbox"/> PENDING

Department Director

Date

Alan Hunter for GHG

03/21/02

SUMMARY OF ECONOMIC IMPACT

This bill is estimated to impact Personal Income Tax revenue as shown in the following table.

Estimated Revenue Impact			
Years Beginning On or After January 1, 2002			
Enactment Assumed After June 30, 2002			
Fiscal Years			
(In Millions)			
Credits:	2002-03	2003-04	2004-05
Teacher Retention	-\$150	-\$115	-\$123
Private School	-\$300	-\$270	-\$290
Home-School	-\$59	-\$57	-\$58
Total Impact	-\$509	-\$442	-\$471

This analysis does not consider the possible changes in employment, personal income, or gross state product that could result from this measure.

ANALYSIS

1. TEACHER RETENTION CREDIT

FEDERAL/STATE LAW

Current state law allows a tax credit for credentialed teachers based upon the taxpayer's years of service as a credentialed teacher. The credit amount varies as follows:

Years of Service	Credit Amount
At least 4 but less than 6 years	\$250
At least 6 but less than 11 years	\$500
At least 11 but less than 20 years	\$1,000
20 or more years	\$1,500

The credit cannot exceed 50% of the amount of tax that would be imposed on a teacher's salary, excluding pensions or other deferred compensation, after application of the standard deduction or itemized deductions.

THIS BILL

This bill would increase the amount of the teacher retention credit by \$500 in each category of years of service and reduce the minimum years of service requirement for the first credit level to one year. The new credit amount would vary as follows:

Years of Service	Credit Amount
At least 1 but less than 6 years	\$750
At least 6 but less than 11 years	\$1,000
At least 11 but less than 20 years	\$1,500
20 or more years	\$2,000

IMPLEMENTATION CONSIDERATIONS

Implementing this bill would require some changes to existing tax forms and instructions and information systems, which could be accomplished during the normal annual update.

TECHNICAL CONSIDERATIONS

The bill adds an operative date at the end of the teacher retention credit (page 4, lines 1 through 3 of the bill). This date is unnecessary as the California Constitution and Revenue and Taxation Code Section 18415 already provide the same operative date. Amendment 1 would remove the unnecessary language.

LEGISLATIVE HISTORY

AB 2879 (Jackson, Stats. 2000, Ch. 75) enacted the teacher retention tax credit. AB 1080 (Villaraigosa, Stats. 2000, Ch. 603) simplified the method of determining tax imposed on a teacher's salary for purposes of the credit limitation contained in the teacher retention tax credit. AB 110 (Zettel, Stats. 2001, Ch. 410) prevents the Franchise Tax Board from imposing the accuracy-related penalty on taxpayers who incorrectly claim the teacher retention credit for the 2000 taxable year.

AB 149 (Zettel 2001/2002) would have extended the teacher retention tax credit to credentialed individuals who provide support services to students (e.g., school psychologists, language specialists, counselors, and school nurses) and to preschool, prekindergarten, and adult education teachers that are credentialed. AB 149 died because it failed to pass to the second house before the constitutional deadline.

OTHER STATES' INFORMATION

Review of *Illinois*, *Massachusetts*, *Michigan*, *Minnesota*, and *New York* laws found no comparable tax credits. These states were reviewed because of the similarities between California income tax laws and their tax laws.

FISCAL IMPACT

This provision of the bill would not significantly impact the department's costs.

ECONOMIC IMPACT

Revenue Estimate

This provision would result in revenue losses of \$150 million for fiscal year 2002-03, \$115 million for fiscal year 2003-04, and \$123 million for fiscal year 2004-05.

Revenue Discussion

The revenue impact for this credit will be determined by the number of qualified teachers, length of service, and the amount of credits that can be applied against available tax liabilities.

It is projected that for the first tax year, 2002, approximately 400,000 public and private school kindergarten to 12th grade teachers will qualify for the proposed credit. Information obtained from the Department of Finance on tenure classes and salaries was used in the analysis. The rate at which credits would be applied against tax was derived from state tax return data for employees with comparable incomes.

2. PRIVATE SCHOOL CREDIT

FEDERAL/STATE LAW

Existing state and federal laws provide various tax credits designed to provide tax relief for taxpayers who incur certain expenses (e.g., child adoption) or to influence behavior, including business practices and decisions (e.g., research credits or economic development area hiring credits). These credits generally are designed to provide incentives for taxpayers to perform various actions or activities that they may not otherwise undertake.

Existing state and federal laws provide some tax benefits related to higher education (e.g., an income exclusion for certain bonds used for education and qualified state tuition program). However, there currently are no tax benefits for elementary school or secondary school expenses.

Existing federal and state laws provide that "gross income" includes all income from whatever source derived, unless specifically excluded. "Adjusted gross income," or AGI, is gross income minus any adjustments to income that can be taken even if itemized deductions are not claimed (e.g., moving expenses, alimony paid, contributions to an individual retirement account).

THIS BILL

This bill would allow a credit for each child of the taxpayer enrolled in and attending a private school. The private school must be located in California and provide education for kindergarten to 12th grade, inclusive, or any part thereof. The amount of the credit per child would be determined by the taxpayer's gross income for the taxable year as follows:

Gross Income for the Taxable Year	Credit per Child
less than \$30,000	\$3,500
at least \$30,000, but less than \$50,000	\$2,500
at least \$50,000, but less than \$100,000	\$1,500
\$100,000 or more	\$500

Only one credit for each child living in the taxpayer's household would be allowed. In the case of a married couple filing separate returns, the credit may be taken by either parent or divided equally between the parents. Any unused credit could be carried over until exhausted.

IMPLEMENTATION CONSIDERATIONS

This provision of the bill would raise the following implementation concerns. Department staff is available to assist the author with any amendments.

- The amount of the credit is determined by the amount of the taxpayer's "gross income." Since department systems capture AGI and not "gross income," the credit amount could not be verified automatically. Generally, when income is used to determine a credit amount or limit a credit, the taxpayer's AGI is used.
- The term "child" is not defined. As currently drafted, grandchildren or foster children may not qualify for the credit, while adult children of the taxpayer may qualify. Undefined terms can lead to disputes between taxpayers and the department.
- It is unclear whether the kindergarten to 12th grade requirement applies to the child's attendance, to the private school, or both. If the requirement only applies to the definition of "private school," a child attending preschool at a private school that also provides kindergarten to 12th grade education would qualify for the credit.
- This bill does not specify how long the child must attend the private school to qualify for the credit. Thus, if a child attends as little as one day, the taxpayer could qualify for the credit.
- The bill does not specify who is eligible for the credit or how the credit should be divided in the case of divorced parents. If the child lives with each parent for part of the year, disputes could arise over which parent is entitled to the credit.
- This bill does not limit the number of years for the carryover period. The department would be required to retain the carryover on the tax forms indefinitely because an unlimited credit carryover period is allowed. Recent credits have been enacted with a carryover period limitation since experience shows credits typically are exhausted within eight years of being earned.

LEGISLATIVE HISTORY

AB 49 (House, 1999/2000) would have created a \$500 credit for each child of the taxpayer attending a private school. AB 49 died because it failed to pass to the second house before the constitutional deadline.

SB 698 (Battin, 2001/2002) would have created a credit for fees paid for extracurricular activities to a public or private school. SB 698 died because it failed to pass to the second house before the constitutional deadline.

OTHER STATES' INFORMATION

The laws of the following states were reviewed because their tax laws are similar to California's income tax laws.

Illinois allows a taxpayer that is the parent or custodian of a qualified pupil a credit for qualified education expenses. Expenses are defined as those costs in excess of \$250 that are incurred on behalf of a pupil for tuition, book fees, and lab fees at an elementary or secondary school in which the pupil is enrolled during the regular school year.

Michigan and *Illinois* provide credits related to higher or post-secondary education. *Massachusetts* provides a deduction for college tuition payments. *New York* allows taxpayers to choose either a college tuition expense deduction or an income tax credit for college tuition.

FISCAL IMPACT

If the bill is amended to resolve the implementation considerations addressed in this analysis, the department's costs are expected to be minor.

ECONOMIC IMPACT

Revenue Estimate

This provision would result in revenue losses of \$300 million for fiscal year 2002-03, \$270 million for fiscal year 2003-04, and \$290 million for fiscal year 2004-05.

Revenue Discussion

The revenue impact for this credit is dependent upon the number of students enrolled in kindergarten to 12th grade private schools and the amount of credits that can be applied against available tax liabilities.

It is projected that approximately 650,000 California kindergarten to 12th grade students will be enrolled in private schools in 2002. This estimate incorporates an estimated incentive effect based on this credit in computing the annual increase in the number of students attending private schools. Information obtained from the California Department of Education and the U. S. Census Bureau was used in the analysis.

It should be noted that the 2001 tax threshold for married filing joint taxpayers with two dependents is \$38,770 in AGI (standard deduction applied). Taxpayers with less income than this threshold amount do not incur a California tax liability. Married filing joint taxpayers with two or more dependents that fall within the lower AGI ranges will not receive benefit from this proposed credit. The tax threshold would be even higher for taxpayers who itemize deductions.

ARGUMENTS/POLICY CONCERNS

This bill does not contain a sunset date. Sunset dates generally are provided to allow periodic review by the Legislature.

Credits generally are designed to encourage a behavior. This bill would allow a credit for behavior in which taxpayers may be currently engaged. For example, a taxpayer currently enrolling his or her child in a private school would receive this credit.

3. HOME-SCHOOL CREDIT

FEDERAL/STATE LAW

See the “Federal/State Law” discussion for the Private School Credit.

THIS BILL

This bill would create a credit for taxpayers that home school their children. The credit would be equal to 50% of the cost paid or incurred for providing home-school education for kindergarten to 12th grade inclusive, or any part thereof, for any child of the taxpayer. The maximum amount of the credit allowed per year would be limited by the taxpayer’s gross income for the taxable year as follows:

Gross Income for the Taxable Year	Maximum Credit Amount
less than \$30,000	\$2,000
at least \$30,000, but less than \$50,000	\$1,500
at least \$50,000, but less than \$100,000	\$1,000
\$100,000 or more	\$500

Any unused credit could be carried over until exhausted.

IMPLEMENTATION CONSIDERATIONS

This provision of the bill would raise the following implementation concerns. Department staff is available to assist the author with any amendments.

- The amount of the credit is determined by the amount of the taxpayer’s “gross income.” Since department systems capture AGI and not “gross income,” the credit amount could not be verified automatically. Generally, when income is used to determine a credit amount or limit a credit, the taxpayer’s AGI is used.
- The terms “child” and “home school” are not defined. Undefined terms can lead to disputes between taxpayers and the department.
- It is unclear whether the credit limitation amounts apply per taxpayer or per child being home schooled. For example, if a taxpayer’s gross income is less than \$30,000 and he paid \$5,000 to home school two children, it is unclear whether the maximum credit is \$2,000 or \$4,000.
- This bill does not limit the number of years for the carryover period. The department would be required to retain the carryover on the tax forms indefinitely because an unlimited credit carryover period is allowed. Recent credits have been enacted with a carryover period limitation since experience shows credits typically are exhausted within eight years of being earned.

TECHNICAL CONSIDERATIONS

Generally, dollar amounts are written alphabetically, followed by the numerical amount. However, one numerical dollar amount was omitted from the bill. Amendment 2 would add the numerical dollar amount.

OTHER STATES' INFORMATION

See the "Other States' Information" discussion for the Private School Credit.

FISCAL IMPACT

If the bill is amended to resolve the implementation considerations addressed in this analysis, the department's costs are expected to be minor.

ECONOMIC IMPACT

Revenue Estimate

This credit would result in revenue losses of \$59 million for fiscal year 2002-03, \$57 million for fiscal year 2003-04, and \$58 million for fiscal year 2004-05.

Revenue Discussion

The revenue impact for this credit is dependent upon the number of kindergarten to 12th grade home schooled students, the expenses paid or incurred in home schooling these children, and the amount of credits that can be applied against available tax liabilities.

It is projected that approximately 120,000 California kindergarten to 12th grade students will be home schooled in 2002. It is assumed that the credit limitations provided is per child. Eligible costs for the credit are not specifically defined. This estimate incorporates an estimated incentive effect based on this credit in computing the annual increase in the number of students being home schooled. Information obtained from the California Department of Education, the U. S. Census Bureau, and various home schooling experts was used in the analysis.

The comments regarding tax thresholds discussed in the private school credit also applies to this credit.

ARGUMENTS/POLICY CONCERNS

The policy concerns discussed under Private School Credit also apply to this credit. See "Arguments/Policy Concerns" discussion for the Private School Credit.

In addition, the bill would allow a credit for children home schooled in another state since the bill does not require it to be provided in California. This could be resolved by limiting the credit to home school programs approved by a California school board or some other appropriate state or local agency.

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FRANCHISE TAX BOARD'S
PROPOSED AMENDMENTS TO AB 2664
As Introduced February 22, 2002

AMENDMENT 1

On page 4, delete lines 1 through 3, inclusive

AMENDMENT 2

On page 5, line 13, after "dollars" insert:

(\$1,000)